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VIA E-MAIL AND USPS

December 21, 2010

Mr. Russell U. Crosby  
 Director  
 City of San Jose Police and Fire Department Retirement Plan  
 1737 North First Street, Suite 580  
 San Jose, CA 95112-4505

**Re: City of San Jose Police and Fire Department Retirement Plan  
 Assumptions Recommended for the June 30, 2010 Retiree Health  
 Actuarial Study**

Dear Russell:

We have provided in this letter the actuarial assumptions that we would recommend to the Board for the June 30, 2010 retiree health cash funding and GASB 43/45 accounting disclosure valuations.

The health care trend assumptions used in the health valuation are reviewed annually. Every year Segal publishes a set of health care trend assumptions based on the latest research and information available to our health actuaries. The health care trend assumptions take into account factors such as: recent and expected premium increases affecting our clients, changes in utilization of health care and cost shifting from Medicare.

Other assumptions such as the proportion of members expected to be covered by each health benefit provider (e.g. Kaiser, etc.) may be volatile due to the dynamic nature of the health care market place. That proportion is typically based on the enrollment experience among the current retirees at the most recent annual open enrollment.

Following are our recommended assumptions for the June 30, 2010 health plan studies:

1. **Health care trend assumptions** – The detailed health care trend assumptions we are recommending to the Board are outlined in Item 1 of the Attachment.

Benefits, Compensation and HR Consulting Offices throughout the United States and Canada



Founding Member of the Multinational Group of Actuaries and Consultants, a global affiliation of independent firms

Based on Segal's recent national health plan cost trend analysis, we have increased the starting trend rate for medical plans. In the prior valuation, the trend rate to project the first unknown calendar year premium had been set at 8.5%, grading down by 0.5% each year until an ultimate rate of 5.0% was reached after seven years. For this valuation, we are recommending the first year trend rate be set at 10.0%, grading down by 0.5% each year until an ultimate rate of 5.0% is reached after ten years.

In developing the ultimate health care trend assumption of 5%, we have continued to rely on Segal's research and analysis on long-term cost in the health care market as a whole.

2. **Per capita health care costs** – These costs are used to project the premiums for current active members when they retire. Based on the percentage of retired members, spouses and beneficiaries electing health coverage and the proportion of members enrolled in each available medical plan, we have developed the per capita health premium costs for a member who is covered in calendar year 2010.

Based on the June 30, 2010 membership data, we have provided in the Attachment the observed election rates among the different medical plans. Based on the additional experience for 2009-2010, we propose a change in the distribution of plan election for eligible retirees under age 65 who would elect medical coverage in the future. The election assumption is shown in Item 3 of the Attachment.

In addition, consistent with our understanding of previous valuation practices, we would continue to assume that the Plan's health subsidy would increase at the same rate as the medical trend.

The per capita costs for the dental plan that we would use for the June 30, 2010 study are also provided in Item 2(e) of the Attachment.

3. **Other assumptions and methods** – The other demographic assumptions would be consistent with those we recommended in our July 1, 2005 to June 30, 2009 experience study. These include: mortality, disability incidence, service retirement and withdrawal.

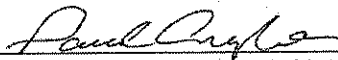
The funding methodologies and the associated discount rates for determining the cash funding contribution rates and for determining the accounting disclosure requirements under GASB 43/45 are also provided in Items 3(a) and (b) of the Attachment.

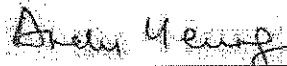
As noted in Item 3(b), in determining the discount rate for accounting disclosure, we have relied on input from the City and used a 4.75% return assumption for City assets. This discount rate will be incorporated in setting the weighted average discount rate for GASB 43/43 disclosure.

Mr. Russell U. Crosby  
December 21, 2010  
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We look forward to discussing this with you and your Board. Please let us know if you have any questions.

Sincerely,

  
\_\_\_\_\_  
Paul Angelo, FSA, EA, MAAA, FCA  
Senior Vice President and Actuary

  
\_\_\_\_\_  
Andy Yeung, ASA, EA, MAAA  
Vice President and Associate Actuary

TXB/gxk  
Enclosures

cc: Veronica Niebla  
Michael Moehle  
Carmen Racy-Choy

# Attachment

## Comparison of Current and Recommended Actuarial Assumptions For the June 30, 2010 Health Valuations

### 1) Health Care Trend Rates

MEDICAL TRENDS USED IN JUNE 30, 2009 CASH FUNDING AND GASB 43/45 VALUATIONS						
Trends to be applied in following fiscal years, to all health plans.						
Trend is to be applied to premium for shown fiscal year to calculate next fiscal year's projected premium						
First Fiscal Year (July 1, 2009 through June 30, 2010)						
PLAN	Blue Shield PPO/POS, Under Age 65	Blue Shield PPO/POS, Age 65 and Over	Kaiser HMO, Under Age 65	Kaiser Senior Advantage	Blue Shield HMO, All Ages	
Trend to be applied to 2009- 2010 Fiscal Year premium	10.89%	10.89%	9.54%	6.92%	9.97%	
The fiscal year trend rates are based on the following calendar year trend rates:						
Fiscal Year	Trend (Approximate)		Calendar Year	Trend (applied to calculate following year premium)		
2010-2011	8.25%		2010	8.50%		
2011-2012	7.75%		2011	8.00%		
2012-2013	7.25%		2012	7.50%		
2013-2014	6.75%		2013	7.00%		
2014-2015	6.25%		2014	6.50%		
2015-2016	5.75%		2015	6.00%		
2016-2017	5.25%		2016	5.50%		
2017-2018 and later	5.00%		2017 and later	5.00%		
Dental Premium Trend 5.00% for all years						
Medicare Part B Premium Trend The 2010-2011 fiscal year premium is assumed to increase 2.5% from the 2009-2010 fiscal year premium. Premiums after 2010-2011 are assumed to increase with 5% annual trend.						

# Attachment

## Comparison of Current and Recommended Actuarial Assumptions For the June 30, 2010 Health Valuations

PROPOSED MEDICAL TRENDS FOR JUNE 30, 2010 FUNDING AND GASB 43/45 VALUATIONS					
Trends to be applied in following fiscal years, to all health plans.					
Trend is to be applied to premium for shown fiscal year to calculate next fiscal year's projected premium					
First Fiscal Year (July 1, 2010 through June 30, 2011)					
PLAN	Blue Shield PPO/POS, Under Age 65	Blue Shield PPO/POS, Age 65 and Over	Kaiser HMO, Under Age 65	Kaiser Senior Advantage	Blue Shield HMO, All Ages
Trend to be applied to 2010-2011 Fiscal Year premium	7.11%	7.11%	9.50%	9.04%	7.11%
The fiscal year trend rates are based on the following calendar year trend rates:					
Fiscal Year	Trend (Approximate)	Calendar Year		Trend (applied to calculate following year premium)	
2011-2012	9.75%	2011		10.00%	
2012-2013	9.25%	2012		9.50%	
2013-2014	8.75%	2013		9.00%	
2014-2015	8.25%	2014		8.50%	
2015-2016	7.75%	2015		8.00%	
2016-2017	7.25%	2016		7.50%	
2017-2018	6.75%	2017		7.00%	
2018-2019	6.25%	2018		6.50%	
2019-2020	5.75%	2019		6.00%	
2020-2021	5.25%	2020		5.50%	
2021-2022 and later	5.00%	2021 and later		5.00%	
Dental Premium Trend					
5.00% for all years					
Medicare Part B Premium Trend					
The 2011-2012 fiscal year premium is assumed to increase 2.5% from the 2010-2011 fiscal year premium (based on the calendar year premium for 2011 remaining unchanged from 2010). Premiums after 2011-2012 are assumed to increase with 5% annual trend.					

# Attachment

## Comparison of Current and Recommended Actuarial Assumptions For the June 30, 2010 Health Valuation

### 2)(a) Per Capita Costs Used in June 30, 2009 Valuation – Participant Under Age 65

2009 Calendar Year		2010 Calendar Year	
CARRIER		CARRIER	
Kaiser	Monthly Premium	Monthly Premium	Monthly Premium
	Maximum Subsidy	Maximum Subsidy	Maximum Subsidy
	Subsidy	Subsidy	Subsidy
Blue PPO/POS	Monthly Premium	Monthly Premium	Monthly Premium
	Maximum Subsidy	Maximum Subsidy	Maximum Subsidy
	Subsidy	Subsidy	Subsidy
Blue Shield HMO	Monthly Premium	Monthly Premium	Monthly Premium
	Maximum Subsidy	Maximum Subsidy	Maximum Subsidy
	Subsidy	Subsidy	Subsidy
2009-2010 Fiscal Year		2009-2010 Fiscal Year	
CARRIER	Observed	Election Percent Used in Valuation	Observed
	47.9		29.8
	29.8		22.3
Blue PPO/POS	Monthly Premium	Election Percent Used in Valuation	Monthly Premium
	Maximum Subsidy		Maximum Subsidy
	Subsidy		Subsidy
Blue Shield HMO	Monthly Premium	Election Percent Used in Valuation	Monthly Premium
	Maximum Subsidy		Maximum Subsidy
	Subsidy		Subsidy

# Attachment

## Comparison of Current and Recommended Actuarial Assumptions For the June 30, 2010 Health Valuation

### 2)(b) Per Capita Costs Used in June 30, 2009 Valuation – Participant Age 65 and Older

2009 Calendar Year	Single Party			Married/with Domestic Partner			Surviving Spouse/ Domestic Partner		
	Monthly Premium	Maximum Subsidy	Subsidy	Monthly Premium	Maximum Subsidy	Subsidy	Monthly Premium	Maximum Subsidy	Subsidy
<b>CARRIER</b>									
Kaiser Senior Advantage	\$414.31	\$443.96	\$414.31	\$828.62	\$1,105.46	\$828.62	\$414.31	\$443.96	\$414.31
Blue Shield PPO or POS	\$521.00	\$443.96	\$443.96	\$1,042.00	\$1,105.46	\$1,042.00	\$521.00	\$443.96	\$443.96
Blue Shield HMO	\$375.20	\$443.96	\$375.20	\$750.40	\$1,105.46	\$750.40	\$375.20	\$443.96	\$375.20
PacificCare	\$378.90	\$443.96	\$378.90	\$757.80	\$1,105.46	\$757.80	\$378.90	\$443.96	\$378.90
2010 Calendar Year	Single Party			Married/with Domestic Partner			Surviving Spouse/ Domestic Partner		
	Monthly Premium	Maximum Subsidy	Subsidy	Monthly Premium	Maximum Subsidy	Subsidy	Monthly Premium	Maximum Subsidy	Subsidy
<b>CARRIER</b>									
Kaiser Senior Advantage	\$429.78	\$484.06	\$429.78	\$859.56	\$1,205.20	\$859.56	\$429.78	\$484.06	\$429.78
Blue Shield PPO or POS	\$582.86	\$484.06	\$484.06	\$1,165.72	\$1,205.20	\$1,165.72	\$582.86	\$484.06	\$484.06
Blue Shield HMO	\$412.46	\$484.06	\$412.46	\$824.92	\$1,205.20	\$824.92	\$412.46	\$484.06	\$412.46
PacificCare	\$395.48	\$484.06	\$395.48	\$790.96	\$1,205.20	\$790.96	\$395.48	\$484.06	\$395.48
2009-2010 Fiscal Year	Single Party			Married/with Domestic Partner			Surviving Spouse/ Domestic Partner		
	Monthly Premium	Maximum Subsidy	Subsidy	Monthly Premium	Maximum Subsidy	Subsidy	Monthly Premium	Maximum Subsidy	Subsidy
<b>CARRIER</b>									
Kaiser Senior Advantage	\$422.05	\$464.01	\$422.05	\$844.09	\$1,155.33	\$844.09	\$422.05	\$464.01	\$422.05
Blue Shield PPO or POS	\$551.93	\$464.01	\$464.01	\$1,103.86	\$1,155.33	\$1,103.86	\$551.93	\$464.01	\$464.01
Blue Shield HMO	\$393.83	\$464.01	\$393.83	\$787.66	\$1,155.33	\$787.66	\$393.83	\$464.01	\$393.83
PacificCare	\$387.19	\$464.01	\$387.19	\$774.38	\$1,155.33	\$774.38	\$387.19	\$464.01	\$387.19

Election Percent	Used in	
	Observed	Valuation
<b>CARRIER</b>		
Kaiser Senior Advantage	35.5	35
Blue Shield PPO or POS	57.0	60
Blue Shield HMO	4.9	5
PacificCare	2.6	0

# Attachment

## Comparison of Current and Recommended Actuarial Assumptions For the June 30, 2010 Health Valuation

### 2)(c) Proposed Per Capita Costs for June 30, 2010 Valuation – Participant Under Age 65

For retirees in pay status, we would use the data on record. Future retirees would have costs assigned according to the following table:

2010 Calendar Year	Single Party		Married/With Domestic Partner		Surviving Spouse/Domestic Partner	
	Monthly Premium	Maximum Subsidy	Monthly Premium	Maximum Subsidy	Monthly Premium	Maximum Subsidy
<b>CARRIER</b>						
Kaiser	\$484.06	\$484.06	\$1,205.20	\$1,205.20	\$484.06	\$484.06
Blue PPO/POS	\$750.02	\$484.06	\$1,927.48	\$1,205.20	\$750.02	\$484.06
Blue Shield HMO	\$540.20	\$484.06	\$1,387.72	\$1,205.20	\$540.20	\$484.06

### 2011 Calendar Year

2011 Calendar Year	Single Party		Married/With Domestic Partner		Surviving Spouse/Domestic Partner	
	Monthly Premium	Maximum Subsidy	Monthly Premium	Maximum Subsidy	Monthly Premium	Maximum Subsidy
<b>CARRIER</b>						
Kaiser	\$527.38	\$496.04	\$1,313.18	\$1,235.16	\$527.38	\$496.04
Blue PPO or POS	\$780.84	\$496.04	\$2,006.70	\$1,235.16	\$780.84	\$496.04
Blue Shield HMO	\$562.40	\$496.04	\$1,444.76	\$1,235.16	\$562.40	\$496.04

### 2010-2011 Fiscal Year

CARRIER	Single Party		Married/With Domestic Partner		Surviving Spouse/Domestic Partner	
	Monthly Premium	Maximum Subsidy	Monthly Premium	Maximum Subsidy	Monthly Premium	Maximum Subsidy
<b>Election Percent</b>						
Recommended For Valuation						
Observed	50.1	50				
25.8	25					
24.1	25					
<b>CARRIER</b>						
Kaiser	\$505.72	\$490.05	\$1,259.19	\$1,220.18	\$505.72	\$490.05
Blue PPO or POS	\$765.43	\$490.05	\$1,967.09	\$1,220.18	\$765.43	\$490.05
Blue Shield HMO	\$551.30	\$490.05	\$1,416.24	\$1,220.18	\$551.30	\$490.05

All Plans shown have a \$10 co-pay, as the \$25 co-pay plans were not available as of the June 30, 2010 census date. We note that the subsidy limits for calendar year 2011 are set equal to the premiums for the Kaiser Plans with \$25 co-pay. In this valuation we will assume that future retirees will not switch from the \$10 co-pay plans to the \$25 co-pay plans because in practice even if some retirees were to switch to the plans with the \$25 co-pay, there is no change in the subsidy amount they would be able to receive from the City of San Jose Police and Fire Department Medical Insurance Program.



# Attachment

## Comparison of Current and Recommended Actuarial Assumptions For the June 30, 2010 Health Valuation

### 2)(d) Proposed Per Capita Costs Used in June 30, 2010 Valuation – Participant Age 65 or Older

2010 Calendar Year	Single Party		Married/With Domestic Partner		Surviving Spouse/Domestic Partner	
	Monthly Premium	Maximum Subsidy	Monthly Premium	Maximum Subsidy	Monthly Premium	Maximum Subsidy
<b>CARRIER</b>		<b>Subsidy*</b>			<b>Subsidy*</b>	<b>Subsidy*</b>
Kaiser Senior Advantage	\$429.78	\$484.06	\$859.56	\$1,205.20	\$859.56	\$429.78
Blue Shield PPO or POS	\$582.86	\$484.06	\$1,165.72	\$1,205.20	\$1,165.72	\$484.06
Blue Shield HMO	\$412.46	\$484.06	\$824.92	\$1,205.20	\$824.92	\$412.46
PacificCare	\$395.48	\$484.06	\$790.96	\$1,205.46	\$790.96	\$395.48

2011 Calendar Year	Single Party		Married/With Domestic Partner		Surviving Spouse/Domestic Partner	
	Monthly Premium	Maximum Subsidy	Monthly Premium	Maximum Subsidy	Monthly Premium	Maximum Subsidy
<b>CARRIER</b>		<b>Subsidy*</b>				<b>Subsidy*</b>
Kaiser Senior Advantage	\$464.16	\$496.16	\$928.32	\$1,235.16	\$464.16	\$464.16
Blue Shield PPO or POS	\$606.82	\$496.04	\$1,213.64	\$1,235.16	\$606.82	\$496.04
Blue Shield HMO	\$429.41	\$496.04	\$858.82	\$1,235.16	\$432.40	\$432.40
PacificCare	\$432.40	\$496.04	\$864.80	\$1,235.16	\$432.40	\$432.40

2010-2011 Fiscal Year	Single Party		Married/With Domestic Partner		Surviving Spouse/Domestic Partner	
	Monthly Premium	Maximum Subsidy	Monthly Premium	Maximum Subsidy	Monthly Premium	Maximum Subsidy
<b>CARRIER</b>		<b>Subsidy*</b>				<b>Subsidy*</b>
Kaiser Senior Advantage	\$446.97	\$490.05	\$893.94	\$1,220.18	\$446.97	\$446.97
Blue Shield PPO or POS	\$594.84	\$490.05	\$1,189.68	\$1,220.18	\$594.84	\$490.05
Blue Shield HMO	\$420.94	\$490.05	\$841.87	\$1,220.18	\$420.94	\$420.94
PacificCare	\$413.94	\$490.05	\$827.88	\$1,220.18	\$413.94	\$413.94

\* Any excess of the maximum subsidy over the premium can be applied toward the Medicare Part B premium. The Medicare Part B premium is \$96.40 per month in 2010 and 2011, before means testing.

## Attachment

### Comparison of Current and Recommended Actuarial Assumptions For the June 30, 2010 Health Valuation

#### 2)(e) Proposed Per Capita Costs used in June 30, 2010 Valuation – Dental Plan

Maximum Dental Subsidy (same as premium)

Carrier	Participation Percent	2010 Calendar Year Subsidy	2011 Calendar Year Subsidy	2010-2011 Fiscal Year Subsidy
Delta	100.0	\$111.48	\$108.62	\$110.05

#### 3) Other Assumptions and Methods

In the June 30, 2010, valuation, we would also apply the following assumptions and methodologies:

##### a. Funding methodologies:

##### i. For funding purposes;

###### Fire Members:

Employer and employee contribution rates would be determined using the Aggregate Cost Method. Under that method, contributions plus current assets would be sufficient to pay medical and dental benefits over the next 10 years.

###### Police Members:

Employer and employee contribution rates would be determined by phasing in over 5 years (beginning with fiscal year 2009/2010) from the contribution rates determined under the Aggregate Cost Method to those determined under the Entry Age Normal (EAN) Method.

Under the Aggregate Cost Method, contribution plus current assets would be sufficient to pay medical and dental benefits over the next 10 years. Under the EAN method, contributions of Normal Cost plus a 30-year closed amortization of the Unfunded Actuarial Accrued Liability, together with the current assets should be sufficient to pay medical and dental benefits over the lifetime of current retirees/beneficiaries and current actives when they retire.

The contribution rates during the 5-year phase-in period would be calculated using a linear or straight-line interpolation. The annual change in the employer and the employee rates cannot exceed 1.35% and 1.25%, respectively. In addition, if the City and the employee rates exceed 11% and 10%, respectively, after the phase-in, both parties would discuss options available to reduce the costs of the plan.

##### ii. For GASB 43/45 purposes, the EAN Method would be used assuming that a single Annual Required Contribution (ARC) rate would be developed for both the Fire and the Police Departments.

## Attachment

### Comparison of Current and Recommended Actuarial Assumptions For the June 30, 2010 Health Valuation

b. Discount rate:

- i) For cash funding purposes, an interest rate of 8.00% per year was used in the valuation as of June 30, 2009. That rate is currently under review by the Board.
- ii) For GASB 43/45 purposes, a weighted average interest rate would be calculated consistent with the methodology used in determining the interest rate for the June 30, 2009 GASB 43/45 valuation.

Under that methodology, we would first compare the ratio of the City's actual cash contributions under the 10-year cash flow funding contribution policy for the Fire Department and the fiscal year 2010/2011 5-year phase-in contribution policy for the Police Department plus the entire implicit subsidy to the City's net Annual Required Contribution (ARC) determined using full accrual accounting. That ratio would be used to weight the return that would be earned on assets invested by the Plan versus the return that the City would earn on its investment.

Based on input from the City, we will use a 4.75% return assumption for City assets. The assumption for the June 30, 2009 valuation was a 5.00% return for City assets.

- c. Demographic assumptions: These include the incidence of service retirement, disability retirement, withdrawal, deferred vested retirement and death. We would apply the same assumptions proposed in our July 1, 2005 to June 30, 2009 experience study.
- d. Expected annual rate of increase in the Plan's health subsidy amount: We have assumed that the Plan's health subsidy amount will increase at the same rate as the anticipated increase in benefit costs. We recommend leaving this assumption unchanged for the June 30, 2010 valuation. We understand that in past years, the medical insurance premium subsidy has been set equal to the under-65 premiums for the lowest cost plans, for employee and family coverage. We note that the increase in subsidy amount from 2010 to 2011 is less than the increase in the premium for Kaiser plan with \$10 co-pay from 2010 to 2011 because a new Kaiser plan with \$25 co-pay is used to set the subsidy limit for 2011.

We assume that future subsidy amounts will increase at the same rate as medical trend unless there are other changes in the level of medical benefit agreed to by the City and the Members.

- e. Percentage of retirees over age 65 covered by Medicare Parts A and B: We would continue to assume that 100% of future retirees would be covered by Medicare Parts A and B after they turn age 65.
- f. Assets: Based on those maintained by the Plan for the payment of medical and dental benefits.
- g. Implicit Subsidy: Our understanding is that retiree premium rates are pooled together with actives and an implicit subsidy does exist. For funding purposes, we would exclude the cost of the implicit subsidy but for GASB 43/45 purposes, we would include the cost of the implicit subsidy.

**Attachment**

**Comparison of Current and Recommended Actuarial Assumptions  
For the June 30, 2010 Health Valuation**

**h. Spouse Age Difference in Years for Retirees with Medical Coverage:**

<b>Average Observed Difference for Spouse</b>	<b>Current &amp; Recommended Assumption</b>
-3.5	-3

**i. Spousal Coverage:**

<b>Member Gender</b>	<b>Observed Percentage Coverage for Spouse</b>	<b>Current &amp; Recommended Assumption</b>
Male and Female	82%	85%

**j. Retiree Medical Coverage Election:**

Proportion of all eligible retirees in pay status as of June 30, 2010 who elected retiree medical coverage	97%
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Current and recommended assumption for eligible members electing medical coverage	95%
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